

**PUBLIC UTILITIES COMMISSION**

505 Van Ness Avenue
San Francisco, Ca 94102-3298

**CALIFORNIA ENERGY COMMISSION**

1516 Ninth Street
Sacramento, California 95814

February 8, 2006

The Honorable Martha Escutia, Chair
Senate Energy, Utilities and Communications Committee
California State Senate
State Capitol, Room 5080
Sacramento, CA 95814

Re: Natural Gas Market Study

Dear Senator Escutia:

Thank you for the opportunity to provide a comprehensive report on natural gas markets. In your letter dated October 17, 2005, you requested that the California Public Utilities Commission (CPUC) and the California Energy Commission work together to study the natural gas market and respond to questions you posed regarding market structure, ownership, market power, and price. The CPUC and the Energy Commission collaborated over the last two months to conduct a thorough and accurate study. The report includes a jointly prepared Executive Summary, sections answering your questions relating to pricing structure (prepared by the CPUC), market concentration (prepared by the CPUC), market participants (jointly prepared), along with technical appendices providing additional detail on the issues you raise (jointly prepared).

In our initial response on November 4, 2005, we described some of the programs and activities the two agencies implement to support policy development, infrastructure and supply adequacy, price control, and conservation. We also noted that some of the information you requested falls outside of the scope of our respective jurisdictions. However, we have endeavored to provide you as complete a response as possible to each question in the attached report.

In this report, we describe the U.S. natural gas market, especially as it relates to California. Our agencies found that the increase in natural gas prices Californians pay is primarily a result of increases in the commodity price itself, which has been increasing on a long-term basis since 2002 due to underlying "fundamental" market conditions and "seasonal" events, including: the flat level of natural gas production in the U.S. and Canada despite very high levels of drilling, a significant increase in the demand for natural gas for electrical generation, significantly increased costs of drilling since the mid-1990s, record high oil prices, and increased competition in the

global natural gas market resulting in price increases for LNG supplies to the U.S. Last year, Hurricanes Katrina and Rita temporarily reduced U.S. production by 20 percent resulting in particularly high prices in the late summer and into the fall. While natural gas prices have fallen from those peaks, they remain at high levels relative to the 1990s.

There is ongoing litigation alleging anti-trust and market price manipulation claims against Sempra and its affiliates, including Southern California Gas and San Diego Gas & Electric Company, regarding the natural gas market in California. The attached report did not rely on claims or information presented by any party involved in that litigation.

Both agencies recognize the need to provide compelling information and education to all stakeholders and consumers in the state. We look forward to working with you and your staff as you prepare for the February 28, 2006, Natural Gas Hearing and welcome further discussion regarding future policy direction.

Sincerely,



JOSEPH DESMOND
Chairman
California Energy Commission



MICHAEL R. PEEVEY
President
California Public Utilities Commission

cc: President pro Tempore Don Perata
Geoffrey F. Brown, Commissioner
Dian Grueneich, Commissioner
John Bohn, Commissioner
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Steve Larson, Executive Director

Jackalyn Pfannenstiel, Commissioner
Arthur H. Rosenfeld, Commissioner
James D. Boyd, Commissioner
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